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C O N F I D E N T I A L SECTION 01 OF 04 HARARE 000731

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AF/S FOR B. NEULING
SENIOR AFRICA DIRECTOR C. COURVILLE
TREASURY FOR J. RALYEA AND B. CUSHMAN
COMMERCE FOR B. ERKUL

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TAGS: [ECON](#) [EFIN](#) [PGOV](#) [PREL](#) [ZI](#)
SUBJECT: GOZ POLICIES CRIPPLING BANKING SECTOR

Classified By: Charge d'Affaires, a.i., Eric T. Schultz under Section 1

Summary

¶1. (SBU) Stricter liquidity controls implemented in January by the Reserve Bank of Zimbabwe (RBZ) are sapping the banking sector of vital capital at the same time as the industry struggles to comply with higher capital requirements that take effect later this year. This impending crunch has fueled speculation that some smaller, indigenous banks may fold. Foreign-owned banks will likely weather this storm, mitigating the impact of this development. That said, Zimbabwe's rapidly shrinking economy is producing an even greater long-term threat to the banking sector as banks become dependent on government treasury bills and jettison traditional banking functions. End Summary.

Tighter Liquidity Controls

¶2. (SBU) In a stated attempt to combat inflation, RBZ Governor Gideon Gono last January announced tighter liquidity controls. Statutory reserves for the banking sector were increased to 60 percent for demand deposits and 45 percent for saving deposits, up from the rates of 45 and 30 percent, respectively. Statutory reserves do not earn interest and, given the dominance of demand deposits, absorb about 58 percent of all banking sector deposits, according to independent media accounts. At the same time, Gono announced harsher provisions for settling nightly accounts to stimulate interbank lending of excess funds. Funds held in excess of

the proscribed ratios would be automatically exchanged for 2-year government paper at a punitively low rate of 200 percent interest payable at expiry. Conversely, those banks that find themselves short at the end of the day must borrow from the RBZ's accommodation window at 850 percent secured or 900 percent unsecured, payable the next day.

13. (SBU) In meetings with econoffs over the past few weeks, financial sector insiders have universally condemned the stricter liquidity controls. NMB Bank executive Lionel Chinyamutangira noted that the maturities gap between low-return assets and high-rate liabilities presented a major challenge to funds managers, who now spend much of their day pouring over cash flow data lest they be caught short. Erratic government open market operations have compounded this problem, according to Zimbabwe Allied Banking Group (ZABG) Finance Director Priscilla Mutembwa, as one day the money market can be flush with funds from the expiry of treasury bills and the next day the market can be in a severe deficit as the government moves to mop up spare cash.

14. (SBU) The sector's inability to manage liquidity in this harsh environment is causing banks that once earned profits, at least in nominal terms, to begin to see red. John Legat, the CEO of Imara Asset Management, estimates that this failure to adequately manage funds has forced large banks to borrow an estimated Z\$1 trillion per day from the RBZ's accommodation window to cover nightly shortfalls. Mutembwa noted that the losses to the sector peaked in about April and that, while half year reports due out soon would probably show continued nominal-term gains, the relative good times that the sector enjoyed last year were gone.

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Higher Capital Requirements

15. (SBU) According to FINHOLD principal economist Best Doroh, liquidity controls were introduced at the worst possible time, as the sector was also bracing for the higher capital requirements that are due to come into effect later this year. Doroh said that under new RBZ guidelines, commercial banks would be required to maintain capital bases of at least US\$10 million. This requirement would be phased in; by September banks would have to meet the target using an exchange rate of Z\$10,000 to the US\$, or Z\$100 billion. Then in December, the capital requirement would be calculated using the official interbank rate, which at a current rate of Z\$101,195 to US\$1 equates to more than Z\$1 trillion. Doroh noted that as of last December four of the five largest banks in Zimbabwe had more than Z\$1 trillion in capital, but he suspected that because of the stricter liquidity controls many of them were now short.

Indigenous Banks Look Frail

16. (SBU) Indigenous banks in particular are scrambling to raise enough capital to meet the December requirement and to create a cushion should the RBZ devalue the official rate, as currently expected, which in turn would hike the capital requirements. Metropolitan Bank tops most lists of banks expected to fold but, with only nine branches and few deposits, the impact would be minor. Most local banks, such as Kingdom and NMB, are planning rights issues to raise the necessary funds. Local financial advisor Emma Fundira noted that uncertainty in the local stock market would limit the amount of capital that banks could raise domestically. Investors, she said, would also surely question why Kingdom, for instance, was embarking on a record-setting rights issuance of Z\$1.5 trillion only a year after its last rights issue. For its part, the quasi-government owned ZABG was seeking to raise Z\$1.5-2 trillion through a fund at the

Finance Ministry, according to Mutembwa.

¶17. (SBU) Despite widespread speculation as to which banks were likely to fold, banking sector insiders tell us that most indigenous banks are likely to survive, albeit in some cases by only a hair. Fundira expected that the GOZ was likely to sever its ties to ZABG, which the RBZ formed in 2005 out of the forced consolidation of banks that failed in 2004. Without this backing, Fundira said ZABG could also go under. Meanwhile, Fundira speculated that political ties to Gono and other GOZ officials were likely to keep other indigenous banks, such as CBZ, Premier, and Renaissance, afloat.

Sector Looking to RBZ To Limit Contagion

¶18. (SBU) Bankers with whom we have spoken are confident that the RBZ would successfully prevent possible problems at one bank from impacting the wider financial sector. Recounting the activist role of the RBZ since Gono's appointment in 2003, Mutembwa and Standard Chartered executive Ralph Watungwa separately said that the central bank would intervene at the first sign of weakness. To this end, the RBZ was monitoring capital requirements on a monthly basis

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and regularly meeting with bank executives. Moreover, Stanbic Managing Director Pindie Nyandoro told econoff that the RBZ saw the negative impact of its stricter liquidity controls on the banking sector and said that she expected Gono to reduce the statutory reserves within the next week. She speculated that the RBZ hiked statutory reserves as only a temporary measure to present an improved balance sheet to the IMF and to mop up excess liquidity earlier this year as large amounts of treasury bills expired.

Foreign Banks Safe

¶19. (SBU) Financial contacts were uniform in their confidence that larger, foreign banks would survive the stricter liquidity and capital requirements. The foreign banks largely view the new liquidity and capital requirements as a hiccup in their operations and profitability. There is a consensus, moreover, that despite these immediate problems and the prolonged economic decline, Zimbabwe in the long-term is simply too important of a market to be left out. Fundira said that foreign banks recalled the difficulty of penetrating the South African market and had drawn the conclusion that the cost of pulling out and then reentering Zimbabwe in the future would be prohibitive compared to the cost of simply sustaining operations.

Survivors Face A Grim Future

¶10. (SBU) Although most banks seem likely to survive the coming crunch, according to several industry insiders the rapidly shrinking Zimbabwean economy has created a bigger long-term challenge. According to these executives, Zimbabwean banks no longer earn a profit on the traditional banking functions of issuing loans and accepting deposits. Profits instead are derived from returns on government paper, reducing the once sophisticated banking sector to little more than a discount house.

¶11. (SBU) Nyandoro noted that of Stanbic's Z\$20 trillion assets, about Z\$18 trillion was held in government paper. While treasury bills offered a risk-free return, Nyandoro said the GOZ's continued issuance of debt was unsustainable and that the government was now issuing paper simply to pay the interest charges on expiring paper. Nyandoro and

Watungwa added that the banking sector's problems were also fueling a continuing emigration of skilled professionals. Watungwa confided that he himself would be leaving Zimbabwe next month to join Standard Chartered's office in Boston.

Comment

¶12. (C) We agree with those industry insiders who see the new capital requirements and tight liquidity controls as a manageable crisis but who see the sector's growing dependence on government debt as a real threat to its future.

Banks in Zimbabwe have become glorified bond traders that earn profits, not from lending to productive sectors, but from the government's ever growing deficit. As a result the sector will be poorly positioned to help turn around Zimbabwe's economy when the time comes by mustering needed capital and distributing it to productive enterprises.

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SCHULTZ